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In the Supreme Court of the United States

OCTOBER TERM, 1971

No.

UNITED STATES OF AMERICA, PETITIONER

v.

DOUGLAS B. CARTWRIGHT, AS EXECUTOR OF THE ESTATE OF ETHEL B. BENNETT

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

The Solicitor General, on behalf of the United States of America, petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Second Circuit in this case.

OPINIONS BELOW

The opinion of the district court (Appendix A, *infra*, pp. 12-22) is reported at 323 F. Supp. 769. The opinion of the court of appeals (Appendix B, *infra*, pp. 23-33) is reported at 457 F.2d 567.

JURISDICTION

The judgment of the court of appeals was entered on March 27, 1972 (Appendix C, *infra*, p. 34). The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether Section 20.2031-8(b) of the Treasury Regulations on Estate Tax, which provides that shares in mutual funds are valued for estate tax purposes at the public offering (asked) price, rather than the redemption (bid) price, is valid.

STATUTES AND REGULATIONS INVOLVED

The relevant provisions of the Internal Revenue Code of 1954 and of the Treasury Regulations on Estate Tax (1954 Code) are set forth in Appendix D, *infra*, pp. 35-40.

STATEMENT

At the time of her death on December 4, 1964, the decedent, Ethel B. Bennett, owned shares in three open-end investment companies (mutual funds) registered with and subject to the regulations of the Securities and Exchange Commission. Sections 1 to 53 of the Investment Company Act of 1940, c. 686, 54 Stat. 789 (15 U.S.C. §§ 80a-1 through 80a-52). A mutual fund is an organization which sells shares in itself, and uses the proceeds to invest and trade in securities. The fund issues as many of its shares

as can be marketed, and continually offers its shares to the public. It also continually offers to redeem its outstanding shares, as it is required to do by law (App. A. pp. 12-13; App. B, pp. 24, 26).

The price at which mutual funds offer their shares to the public (the "asked" price) is the net asset value, which is the fractional value per share of the fund's net assets, plus a sales load or sales charge. The sales load is a varying percentage of the offering price, dependent upon the quantity of shares purchased in a single transaction. The maximum sales load of the funds involved here ranged between seven and eight percent and the minimum was one percent.[1] The price at which mutual funds redeem their shares (the "bid" price) is the net asset value. In the normal course of business, all transactions for purchase or sale of shares of open-end investment companies, including the three herein, take place between the investor and the issuing company whose shares are involved (App. A, pp. 15-16; App. B, pp. 24-26).

On the decedent's federal estate tax return, the respondent executor valued the shares of the three funds at their redemption price on the date of the decedent's death. In accordance with Section 20.2031-8(b) of the Treasury Regulations on Estate Tax, the Commissioner determined that these shares should be valued at their public offering price on the date

[1] The investors in these funds also had the option to purchase additional shares with their dividends and capital gains distributions at the redemption or bid price (net asset value) (See App. A, p. 15).

of the decedent's death, and accordingly asserted an estate tax deficiency. After paying the tax, the respondent filed a suit for refund on the ground that Section 20.2031-8(b) is arbitrary, unreasonable, and inconsistent with Section 2031 of the Internal Revenue Code of 1954 (App. A, p. 13). Section 2031 requires inclusion in the gross estate of the "value" of all property owned by a decedent at the time of death. The district court agreed with the respondent and held the regulation invalid. The court of appeals affirmed (App. B, pp. 23-24).

REASONS FOR GRANTING THE WRIT

The regulation held invalid by the Second Circuit is reasonable and consistent with statutory law. There is a direct conflict among the circuit courts of appeal, and a resolution of that conflict is necessary to promote the orderly administration of related provisions of the estate, gift and income tax laws.

1. The decison below together with the recent decision of the Ninth Circuit (one judge dissenting) in *Davis* v. *United States*, rendered May 23, 1972, affirming 306 F. Supp. 949 (C.D. Calif.), is in direct conflict with decisions of the courts of appeals for the Sixth and Seventh Circuits.[3] In *Ruehlmann* v.

[3] The decision also conflicts with *Estate of York* v. *Commissioner*, 28 T.C.M. 1271, but is in agreement with *Hicks* v. *United States*, 335 F. Supp. 474 (D. Colo.), where no appeal was taken by the United States because of the dismissal of taxpayer's complaint on other grounds. *Hicks* is before the

Commissioner, 418 F. 2d 1302, affirming 50 T.C. 871, certiorari denied, 398 U.S. 950, rehearing denied, 400 U.S. 856, the Sixth Circuit sustained the Commissioner's regulation requiring mutual funds to be valued at their asked price for estate tax purposes. And the Seventh Circuit, in *Howell* v. *United States*, 414 F. 2d 45, sustained the gift tax counterpart of Section 20.2031-8(b) (Appendix D, *infra*, pp. 37-40), Section 25.2512-6(b) of the Treasury Regulations on Gift Tax (1954 Code) (Appendix D, *infra*, p. 40-41), which requires that mutual funds be valued at their asked price for gift tax purposes.

2. Because of the large number of persons who hold shares in mutual funds,[3] the valuation issue presented in this case is of very wide administrative significance. More than thirty cases involving this issue are pending, and now that two appellate courts have held for the first time that the Commissioner's method of valuation is invalid, it is likely that the number of cases will rapidly increase unless a definitive conclusion of the issue is reached.

3. Section 2031 of the Internal Revenue Code of 1954 (Appendix D, *infra*, p. 36) requires inclusion in the gross estate of the "value" of all property owned by a decedent. Section 20.2031-1(b) of the

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Tenth Circuit (No. 72-1360) on taxpayer's appeal. The issue is also pending before the Court of Claims in *Lyons* v. *United States*, No. 354-90, argued January 12, 1972.

[3] According to official figures on file with the Securities and Exchange Commission, the total value of open end load fund shares held by investors on December 31, 1971, was 45.5 billion dollars.

regulations (App. D, *infra*, pp. 37-39), implementing that provision, provides that the value of property in the estate is determined by reference to the "fair market value" of the property, which is defined as "the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts."

The underlying assumption of the "willing buyer-willing seller" rule is that the most realistic and appropriate value to place upon assets is the amount that the general public is willing to pay on the open market for the property in question. Consistent with this general formula for valuation, Section 20.2031-8(b) of the Regulations provides that mutual fund shares are valued at the "asked" price, *i.e.*, the price which a willing buyer would pay to acquire shares from the fund. Section 20.2031-8(b) is, in this regard, an application of the principle set forth in Section 20.2031-1(b) that the fair market value of an item sold at retail is its retail price; for example, the value of an automobile is the price at which the automobile would be sold to a member of the general public, not the lower price at which the automobile might be sold back to a dealer.

The concept of value reflected in Sections 20.2031-1(b) and 20.2031-8(b) has been approved by this Court in a series of cases in which the discrepancy between the cost of acquisition and the amount which could be realized on redemption of the asset in question was considerably greater than in this case. In

Guggenheim v. *Rasquin*, 312 U.S. 254; *Powers* v. *Commissioner*, 312 U.S. 259; and *United States* v. *Ryerson*, 312 U.S. 260, the Court held that the replacement cost of certain single-premium life insurance policies, rather than the substantially lower cash surrender value, determined the value of those policies for federal gift tax purposes. The courts below sought to distinguish these cases from the instant case on the ground that the insurance policies at issue in *Guggenheim*, *Powers*, and *Ryerson* contained certain features and privileges, such as the right to receive the face amount of the policy at death, which gave them an inherent value greater than the cash surrender value. This is, to some extent, true of the mutual fund shares at issue here, which, in addition to their cash redemption value, entitle the owner to use his ordinary income and capital gain dividends to purchase new shares in the fund at the "bid" price, *i.e.*, without paying the ordinary load charge (supra, p. 3, note 1).

In any event, the distinction drawn between the instant case and the decisions of this Court shows that the courts below failed to understand the basis of those decisions. The Court in *Guggenheim* did not question the willing buyer-willing seller rule then set forth in Treasury Regulations 79, Art. 19(1), nor did it question the notion that replacement cost is ordinarily the appropriate value to place upon property for tax purposes. The Court referred to the added value inherent in the special features of the single-premium insurance policies not in order to

restrict application of the Commissioner's approach to situations in which property has significant value beyond its cash redemption value, but, rather, in response to taxpayer's argument that "[T]he market for insurance contracts is usually the issuing companies or the banks who will lend money on them" and that "banks will not loan more than the cash-surrender value." The Court enumerated the other features of the policy in order to illustrate that "[a]ll of the economic benefits of a policy must be taken into consideration in determining its value * * *" 312 U.S. at 256-257, concluding that "[T]he value of these policies at the date of the gift was the amount which the insured had expended to acquire them. Cost is cogent evidence of value." 312 U.S. at 257-258.

It may well be that the Commissioner could have taken a different approach to determining "value" within the meaning of Section 2031. The Regulations might, for example, have provided for a determination of value based exclusively upon the amount which the estate would realize upon liquidation of the asset in question, rather than upon the amount which a purchaser in the public market would have to pay for the property.[4] It is well settled,

[4] If the executor of the estate sold the mutual fund shares, it would be rare that the estate would be taxed on more than the bid price, because Section 20.2053-3(d)(2) of the Treasury Regulations on Estate Tax (1954 Code) (26 C.F.R.) allows a deduction for the difference between the redemption price and the public offering price if the shares are sold in order to pay the decedent's debts, expenses of administration, or taxes, to preserve the estate, or to effect distribution. If

however, that a Treasury regulation is not invalid merely because there is an alternative method of implementing the statute, but only if the method set forth in the Regulation is unreasonable of patently inconsistent with the statute. As the Court stated in *United States* v. *Correll*, 389 U.S. 299, 306-307:

> Alternatives * * * are of course available. Improvements might be imagined. But we do not sit as a committee of revision to perfect the administration of the tax laws. Congress has delegated to the Commissioner, not to the courts, the task of prescribing "all needful rules and regulations for the enforcement" of the Internal Revenue Code. 26 U.S.C. § 7805(a). In this area of limitless factual variations, "it is the province of Congress and the Commissioner, not the courts, to make the appropriate adjustments." *Commissioner* v. *Stidger*, 386 U.S. 287, 296. The role of the judiciary in cases of this sort begins and ends with assuring that the Commissioner's regulations fall within his authority to implement the congressional mandate in some reasonable manner.

We submit that Section 20.2031-8(b) of the Regulations embodies a reasonable judgment by the Com-

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the shares are acquired by a beneficiary from the estate and sold by him at a price below the estate-tax valuation, the ensuing difference would be deductible as a loss for income tax purposes. Sections 1001 and 1002, Internal Revenue Code of 1954 (26 U.S.C.); Section 1.1014-1, Treasury Regulations on Income Tax (1954 Code) (26 C.F.R.); *Levin* v. *United States*, 373 F.2d 434 (C.A. 1). In view of these provisions, there is little basis for respondent's contention below that the Regulation in question causes hardship to the owners of mutual funds.

missioner that the value of property, in this case mutual fund shares, is the amount that a willing purchaser would pay to acquire that property, and consequently, that the regulation is valid.

4. The valuation of mutual funds is important not only in the estate and gift tax area, but it also has a significant impact on income taxes. Section 1014 of the 1954 Code (Appendix D, *infra*, p. 35) provides that property acquired from a decedent shall take as its basis for income tax purposes the fair market value of the property as determined for estate tax purposes. Similarly, Section 1015 of the 1954 Code (Appendix D, *infra*, p. 35) provides that in certain situations the fair market value of properties acquired by gift determines the basis of those properties in the hands of the donee. Accordingly, the higher estate and gift tax yield from the Commissioner's method of valuing mutual fund shares may be partially or entirely offset by the higher tax bases of such shares for income tax purposes. Indeed, a relatively small fraction of estates actually pay any federal estate tax and relatively few gifts are so large as to be subject to the gift tax, but the higher income tax basis is allowed whether or not an estate or gift tax has been paid. Consequently, the fiscal impact of the method used for valuing shares of this type is probably not of great importance either to the Commissioner or to taxpayers as a class, who would generally prefer to used the asked price for income tax purposes and the bid price for estate and gift tax purposes. A definitive resolution

of the issue, however, is necessary in order to bring about a uniform method of valuation that can be applied in all three contexts.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

ERWIN N. GRISWOLD,
Solicitor General.

SCOTT P. CRAMPTON,
Assistant Attorney General.

RICHARD B. STONE,
Assistant to the Solicitor General.

LORING W. POST,
DAVID ENGLISH CARMACK,
Attorneys.

JUNE 1972.

APPENDIX A

IN THE
UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF NEW YORK

Civil No. 1968-164

DOUGLAS B. CARTWRIGHT, as Executor of the Estate of ETHEL B. BENNETT, PLAINTIFF

v.

UNITED STATES OF AMERICA, DEFENDANT

OPINION

This action was commenced by the plaintiff to recover $3,092.59 in estate taxes and interest. The dispute arose over the proper method of valuation of mutual fund shares in an estate tax proceeding.

Ethel Bennett died testate on December 4, 1964, owning the following shares in mutual funds:

Investors Mutual, Inc.	2568.422 (in her individual name) 2067.531 (in her name as trustee for Dorothy B. Cartwright)
Investors Stock Fund, Inc.	2269.376
Investors Selective Fund, Inc.	1869.159

Investors Mutual, Inc., Investors Stock Fund, Inc., and Investors Selective Fund, Inc. [hereinafter referred to as "the funds"] are open end investment

companies registered with and subject to the regulations of the Securities and Exchange Commission. They are regulated by Sections 1 through 53 of the Investment Company Act of 1940 [15 U.S.C. §§ 80 (a) (1) through 80 (a) (52)]. The funds were organized and are managed by Investors Diversified Services, Inc., not an open end investment company but the underwriter, distributor, and manager for the funds.

Upon the death of Ethel Bennett, her executor reported the value of the shares on the estate tax return at their net asset value, also called the bid or redemption price. The Commissioner of Internal Revenue assessed a deficiency on the estate tax, claiming that the estate tax value of these shares was the asked for or public offering price. The executor paid the deficiency on the accrued interest and, on December 6, 1967, filed a claim for refund of federal estate taxes and interest in the amount of $3,092.59.

The issue is whether Treasury Regulation 20.2031-8(b) (1963),[1] which requires that shares in mutual

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[1] Sec. 20.2031-8

* * * *

(b) *Valuation of shares in an open-end investment company.* (1) The fair market value of a share in an open-end investment company (commonly known as a "mutual fund") is the public offering price of a share, adjusted for any reduction in price available to the public in acquiring the number of shares being valued. In the absence of an affirmative showing of the public offering price in effect at the time of death, the last public offering price quoted by the company for the date of death shall be presumed to be the applicable public offering price. If the alternate valuation under section 2032 is elected, the last public offering price quoted by the company for the alternate valuation date shall be the applicable public offering price. If there is no public offering price quoted by the company for the applicable valuation date (*e.g.*, the valu-

funds be valued for estate tax purposes at the public offering or asked price on the date of death, is reasonable. Plaintiff's position is that the shares should be valued at the redemption price.

The court has considered the extensive stipulation of facts, testimony of witnesses, and the briefs filed by the parties. The following constitutes the findings of fact and conclusions of law.

The regulation was held reasonable and its application by the Commissioner was upheld in *Estate of Wells* v. *Commissioner*, 50 T. C. 871 (1968) (six judges dissenting), aff'd as *Ruehlman* v. *Commissioner*, 418 F. 2d 1302 (6th Cir. 1969), and in *Howell* v. *United States*, 290 F. Supp. 690 (N. D. Ind. 1968), aff'd. 414 F. 2d 45 (7th Cir. 1969). However, in *Davis* v. *United States*, 306 F. Supp. 949 (1969), the court held that the regulation was unreasonable and found for the plaintiff. That decision is on appeal to the Ninth Circuit.

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ation date is a Saturday, Sunday, or holiday), the fair market value of the mutual fund share is the last public offering price quoted by the company for the first day preceding the applicable valuation date for which there is a quotation, adjusted for any reduction in price available to the public in acquiring the number of shares being valued. In any case where a dividend is declared on a share in an open-end investment company before the decedent's death but payable to shareholders of record on a date after his death and the share is selling "ex-dividend" on the date of the decedent's death, the amount of the dividend is added to the ex-dividend quotation in determining the fair market value of the share as of the date of the decedent's death. As used in this paragraph, the term "open-end investment company" includes only a company which on the applicable valuation date was engaged in offering its shares to the public in the capacity of an open-end investment company.

(2) The provisions of this paragraph shall apply with respect to estates of decedents dying after October 10, 1963.

If Treasury Regulation 20.2031-8(b) is reasonable, it must be upheld by the court [*United States* v. *Correll*, 389 U. S. 299, 306-307 (1967)], even if another method of valuing the shares would conform to the statute [*Mearkle's Estate* v. *Commissioner*, 129 F. 2d 386, 388-389 (3rd Cir. 1942)].

The price at which shares in the funds are sold to the investor is the current public offering price or asked price, which is determined by adding the net asset value and the load or sales charge. The net asset value of a share is computed by adding the market value of all securities and other assets owned by the fund and subtracting the liabilities of the fund and dividing that figure by the then total outstanding shares. The load charge usually covers the cost of expenses and profit to the broker,[3] but does not include any management fee. The redemption price or bid price is the current net asset value and does not include the load charge. Ethel Bennett acquired her shares by gift, inheritance, and by purchase at the bid price by reinvesting her capital gains and ordinary dividends. She did not acquire any shares by purchase at the asked price.

If an individual acquires shares in the funds through purchase, he realizes at the time of the original acquisition that he is paying a load charge. He further understands that, if he later wants the

[3] Shares of some mutual funds may be purchased at a public offering price equal to the net asset value. There is no load charge because the companies maintain no dealer organization or staff of sales representatives. Investors are not solicited but must apply directly to the underwriter. The shares of Scudder, Stevens & Clark Fund, Loomis-Sayles Fund, and Stein, Roe & Farnham Fund may be purchased without a load charge.

company to redeem the shares, they will be redeemed on the date of redemption at the net asset value. There are no restrictions on the transferability of shares in the funds, but they are not sold in the securities market. The ordinary and only practical method of disposition is redemption. If the holder disposes of these shares during his lifetime, tax computation is based upon net asset value.

Provisions similar to Section 2030(a) of the Internal Revenue Code of 1954 [26 U. S. C. § 2030(a)], which requires that the gross estate of a decedent shall be determined by including the value of all of his property at the time of death have appeared in the Revenue Act since 1916. Prior to the promulgation of Regulation 20.2031-8(b) (1963), effective after April 10, 1963, there was no regulation specifying how shares in mutual funds should be valued for estate tax purposes. From 1940, when the Investment Company Act became effective, until the early 1960's, the Commissioner had no fixed policy for the valuation of mutual funds. During this period of time, the taxpayer could value the shares at redemption price if he desired. In about the year 1962, some Revenue agents demanded that mutual fund shares in estate tax returns be valued at the asked price or at the mean between the bid and the asked price. However, after taxpayers filed refund actions, the government accepted the bid prices as the fair market value and settled the case.[3]

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[3] The following are some examples of cases the government settled: Two actions were started in the United States District Court for the Western District of New York. In *Wink, as Executor of the Estate of Baldwin* v. *Coyle*, Civil 9864, the Commissioner valued the shares on the mean between the bid and the asked price. In *Metz, as Executor of the Estate of*

The government bases its argument of reasonableness of Treasury Regulation 20.2031-8(b) (1963) on several grounds. The first is that the regulation applies the general principle of valuation expressed in Treasury Regulation 20.2031-1(b) to the valuation of mutual funds shares. Secondly, it brings the valuation of these shares into harmony with cases like *Guggenheim* v. *Rasquin*, 312 U. S. 254 (1941), which held that replacement cost rather than cash surrender value is the correct measure of value of a single premium insurance contract. Thirdly, the argument for reasonableness is based on the fact that no hardship is imposed on the estate or the beneficiaries if they dispose of the shares at a loss. Treasury Regulations Section 20.2053-3(d) (2).[4]

Stern, Civil 10,167, the Commissioner valued the shares at the asked price. On October 11, 1963, the case of *Estate of Wilder* v. *Tomlinson* was filed in the Middle District of Florida. All three cases were settled by the refund to the taxpayer of the excess tax collected.

[4] Sec. 20.2053-3(d)

* * * *

(2) Expenses for selling property of the estate are deductible if the sale is necessary in order to pay the decedent's debts, expenses of administration, or taxes, to preserve the estate, or to effect distribution. The phrase "expenses for selling property" includes brokerage fees and other expenses attending the sale, such as the fees of an auctioneer if it is reasonably necessary to employ one. Where an item included in the gross estate is disposed of in a bona fide sale (including a redemption) to a dealer in such items at a price below its fair market value, for purposes of this paragraph, there shall be treated as an expense for selling the item whichever of the following amounts is the lesser: (i) the amount by which the fair market value of the property on the applicable valuation date exceeds the proceeds of the sale, or (ii) the amount by which the fair market value of the property on the date of the sale exceeds the proceeds of the sale. The principles used in

The government, citing *Commissioner* v. *South Texas Co.*, 333 U. S. 496, 501 (1948), argues that, since the "Regulations constitute a contemporaneous construction by those charged with the administration of the revenue statutes [it] should not be overruled except for weighty reasons."

The general principle of valuation expressed in Treasury Regulation 20.2031-1(b) defines fair market value as "the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts." The government's position is that the only time that the willing buyer-willing seller situation exists in the sale of mutual fund shares is at the time of original sales by the investment company to purchaser. At the time of redemption sale, since the company is under an obligation of law to purchase at the net asset value, it is not a willing buyer, and quite often, since the circumstances of the owner of the shares compel the sale, he is not a willing seller.

This theory disregards the facts of acquisition in many cases, including this one. Mrs. Bennett acquired her shares either by gift, inheritance, or by acquisition at the redemption price, and none at the asked price. It also disregards the fact that, at the time of original purchase, the buyer is fully aware that, at the time of sale back to the company, he will be able to sell the shares back at the net asset value or redemption price, whatever it may be at that time. At the time of original purchase, both the buyer and seller are fully

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determining the value at which an item of property is included in the gross estate shall be followed in arriving at the fair market value of the property for purposes of this paragraph. See §§ 20.2031-1 through 20.2031-9.

cognizant of the facts and willingly enter into the transaction.

As the court pointed out in *Davis* v. *United States*, *supra*, there are two separate markets. The difference in the price in the two markets is the sales commission. To include that in the value of the shares to the estate creates an artificial value that cannot possibly be obtained by the estate in any readily accessible market. The sales commission is for the expense of advertising and marketing only, and adds nothing to the value of the share.

In order to show the reasonableness of the regulation that replacement cost of the mutual fund share, rather than the redemption price, is the correct measure of value, the government cites *Guggenheim* v. *Rasquin*, *supra*. In that case, the taxpayer purchased a single premium life insurance policy for $852,438.50 at the face value of $1,000,000.00. A short time later, she gave the policy to her children. On the gift tax return, she listed the policies at their cash surrender value of $717,344.81. The Commissioner's valuation of the gift at cost of $852,438.50 was upheld by the Supreme Court. The Supreme Court was persuaded by the facts that the owner of the fully paid life insurance policy not only had the right to surrender it, but the right to receive the face amount of the policy upon the insured's death. The court pointed out:

> "An important element in the value of the property is the use to which it may be put. Certainly the petitioner here did not expend $852,438.50 to make an immediate gift limited to $717,344.81. Presumptively the value of these policies at the date of the gift was the amount which the insured had expended to acquire them."

The government argues that *Guggenheim* stands for the principle that, in valuing mutual fund shares, not only the redemption price but the entire bundle of rights which the estate receives must be taken into account. The bundle of rights in *Guggenheim* included the right to receive the face value of the policy at the time of death, and a certainty of insurance coverage if Mrs. Guggenheim became uninsurable.

It appears to this court that the Commissioner's attempt to remold the facts and law of *Guggenheim* to fit the problem of valuation or mutual fund shares is unrealistic and unreasonable.

No doubt there are advantages in holding mutual funds, but mutual funds and insurance policies are so different that the bundle of rights in each cannot be compared.

The value of mutual fund shares fluctuates with the stock market, but an insurance contract has a fixed value. An individual may purchase mutual funds whatever his age or his state of health. However, the question of insurability is an important consideration both to insurance companies and to the holders of insurance policies. Because it is difficult for many individuals to obtain life insurance coverage, the purchase of a life insurance policy is a valuable right. There is no comparable consideration in the purchase of mutual fund shares.

The event of death itself brings about no change in value of a mutual fund share. No payment of any kind is made unless the estate or beneficiary presents the share for redemption. On the other hand, when death occurs, the insurance company pays under the policy, the estate tax is paid, and that is the end of it. Mutual fund shares can pass from estate to estate with a tax paid on each transfer. By Regulation

20.2031-8(b) (1963), the government collects an added tax on the load charge at the time of each transfer. Is it reasonable for this tax to be paid again and again, imposed on the load charge, which adds nothing to the value of the share but pays only for marketing and advertising costs?

The government's argument that no hardship is imposed upon the estate or beneficiaries by this regulation if they dispose of the shares is not convincing. Treasury Regulation 20.2053-3(d)(2), which provides that, if the shares are sold at a loss, the loss is a deductible expense of administration, is of no benefit to the estate or to the beneficiary which does not sell the shares. Furthermore, as the dissent points out in *Wells* v. *Commissioner, supra,* the loss may be taken only under certain limited circumstances. In addition, if the regulation setting fair market value is unreasonable, this unreasonableness cannot be cured by a regulation which limits the hardship imposed upon a taxpayer.

History lends little support to the government's argument that the regulation was designed to bring the valuation of mutual fund shares into harmony with such decisions as *Guggenheim* v. *Rasquin, supra; Powers* v. *Commissioner,* 312 U. S. 259 (1941); *United States* v. *Ryerson,* 312 U. S. 260 (1941); and *Dupont Estate* v. *Commissioner,* 233 F. 2d 210, cert. denied, 352 U. S. 878 (1956). Three of these cases were decided in 1941, and the *Dupont* case, decided in 1956, merely applied the rationale of the *Guggenheim* gift tax case to an estate tax case.

In similar fashion, it is clear that the regulation cannot be deemed a contemporaneous construction of the statute. The statutory definition of value has been

in the Revenue Act since 1916, and this regulation was not promulgated until 1963.

For these reasons, the court determines that Treasury Regulation 20.2031-8(b) (1963) is unreasonable. Judgment shall enter for the plaintiff.

Prepared judgment on notice.

So ordered.

JOHN T. CURTIN,
United States District Judge.

Dated: February 22, 1971.

APPENDIX B

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

No. 73—September Term, 1971.

(Argued November 4, 1971 Decided March 27, 1972.)

Docket No. 71-1542

DOUGLAS B. CARTWRIGHT, as Executor of the Estate of ETHEL B. BENNETT, PLAINTIFF-APPELLEE

v.

UNITED STATES OF AMERICA, DEFENDANT-APPELLANT

Before:

WATERMAN, SMITH and TIMBERS,
Circuit Judges.

WATERMAN, *Circuit Judge:*

We are called upon to decide whether Section 20.2031-8(b) (1963) of the Treasury Regulations on Estate Tax (1954) which requires that shares of open-end investment companies (mutual funds) are to be valued for estate tax purposes at the public offering or publicly posted asked price is a reasonable regulation. The issue reaches us by a government appeal from a decision of Judge John T. Curtin in the United States District Court for the Western District of New York, reported at 323 F. Supp. 769 (1971), in which the district court held that the

regulation was unreasonable. We agree with the court below and affirm the judgment below.

We need not belabor the facts involved in this dispute for they are well set out in the lower court opinion. Ethel Bennett died testate owning shares in three mutual funds which are registered with, and subject to the regulations of, the Securities and Exchange Commission. Upon her death the executor of her estate, Douglas B. Cartwright, filed an estate tax return reporting the value of those shares at their net asset value,[1] that is, at their bid or redemption price. As we have noted, Treasury Regulation 20.-2031-8(b), set forth in the margin,[2] requires that shares in such funds be valued at their public offering price, and, accordingly, the Commissioner of Internal Revenue assessed a deficiency. The executor

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[1] Though the term "net asset value" is fairly self-explanatory, the parties also stipulated to its meaning:

> 9. The "net asset value" is computed daily as of the close of trading on the New York Stock Exchange. The total assets are valued and the total outstanding liabilities, including all reserves and accrued expenses, are subtracted. The resulting net worth is divided by the number of shares outstanding to determine the "net asset value" per share of capital stock. This is generally described as the "bid" price in the financial pages.

[2] Regulation 20.2031-8(b) reads:

> (b) Valuation of shares in an open-end investment company. (1) The fair market value of a share in an open-end investment company (commonly known as a "mutual fund") is the public offering price of a share, adjusted for any reduction in price available to the public in acquiring the number of shares being valued. In the absence of an affirmative showing of the public offering prices in effect at the time of death, the last public offering price quoted by the company for the date of death

paid the assessed deficiency, and then, alleging overpayment of the tax, on December 6, 1967 filed his claim under 28 U.S.C. §§ 1340 and 1346 in the district court for a refund of $3,092.59. In this case the public offering price is the price at which the shares in the mutual funds are marketed and distributed by Investors Diversified Services, Inc. (IDS). IDS is not an open-end investment company but, rather, in addition to its functions of organizing and managing the funds herein involved, it acts in a capacity which is analogous to that of a stockbroker. Shares in the mutual funds organized by IDS are obtained initially by purchase through IDS

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shall be presumed to be the applicable public offering price. If the alternate valuation under section 2032 is elected, the last public offering price quoted by the company for the alternate valuation date shall be the applicable public offering price. If there is no public offering price quoted by the company for the applicable valuation date (e.g., the valuation date is a Saturday, Sunday, or holiday), the fair market value of the mutual fund share is the last public offering price quoted by the company for the first day preceding the applicable valuation date for which there is a quotation, adjusted for any reduction in price available to the public in acquiring the number of shares being valued. In any case where a dividend is declared on a share in an open-end investment company before the decedent's death but payable to shareholders of record on a date after his death and the share is selling "ex-dividend" on the date of the decedent's death, the amount of the dividend is added to the ex-dividend quotation in determining the fair market value of the share as of the date of the decedent's death. As used in this paragraph, the term "open-end investment company" includes only a company which on the applicable valuation date was engaged in offering its shares to the public in the capacity of an open-end investment company.

at a price equal to the net asset value of the shares plus a fee called the sales load or load charge. As found by the court below in 323 F. Supp. at 770-771, the load charge "usually covers the cost of expenses and profit to the broker . . . . [footnote omitted]" The nature of the sales is further clarified by the parties' stipulation of facts for the proceedings below:

> IDS is required by § 22(d) of the Investment Company Act of 1940, 15 U.S.C. § 80a-22, to sell shares in these registered investment companies at the current public offering price described in the prospectus (in this instance net asset value plus a maximum sales charge of 8% of the public offering price). IDS receives, in full payment for its services as distributor of these shares, a distribution fee equal to the amount by which the public offering price exceeds net asset value (a sales charge of a maximum of 8% of the public offering price with lesser percentages applying for quantity sales). The remainder of the purchase price is the "net asset value" which is remitted to the investment company. From its fee, IDS pays commission to its sales representatives and other expenses incident to or in connection with the distribution and sale of the investment companies stock.

The cost the investor paid for the sales load is thereafter lost to him, for the ordinary, and, indeed, the only practical, method of disposing of the shares is through redemption by the company, and shares are redeemed at their net asset value as of the date of redemption.

Appellee disregarded Regulation 20.2031-8(b) and did not include the cost of the sales load as part of the value of his decedent's mutual fund shares, and

thereafter, as stated above, the Commissioner of Internal Revenue assessed a deficiency.

As was observed by the district court at 323 F. Supp. 770:

> If Treasury Regulations 20.2031-8(b) is reasonable, it must be upheld by the court [United States v. Correll, 389 U.S. 299, 306-307, 88 S.Ct. 445, 19 L.Ed. 2d 537 (1967)], even if another method of valuing the shares would conform to the statute [Mearkle's Estate v. Commissioner of Internal Revenue, 129 F.2d 386, 388-389 (3rd Cir. 1942)].

The application of a standard of "reasonableness" to the regulation under consideration has produced varied results. The regulation has been previously considered and held valid in *Ruehlmann* v. *Commissioner of Internal Revenue*, 418 F. 2d 1302 (6 Cir. 1969), *affirming* the Tax Court, 50 T. C. 871 (1968), *cert. denied,* 398 U. S. 950 (1970), *rehearing denied,* 400 U. S. 856 (1970). In *Howell* v' *United States*, 414 F. 2d 45 (7 Cir. 1969), the companion gift tax regulation (Section 25.2512-6(b) (1968)) was held valid. Contrary-wise, in *Davis* v. *United States*, 306 F. Supp. 949 (C. D. Calif. 1969), now on appeal by the Government to the Ninth Circuit (No. 25,736), the district court held that the regulation was unreasonable. Moreover, since Judge Curtin handed down his decision in the instant case, Judge Winner in the United States District Court for the District of Colorado has also ruled in *Hicks* v. *United States*, 335 F. Supp. 474 (1971) that the regulation is unreasonable.

We note that here the Government primarily rests on the same arguments as those it advanced in the

court below. Here, as in the district court, the Government has two main bases for supporting its contention that it is reasonable for estate tax purposes to value mutual fund shares at an amount greater than that which the owner could reasonably expect to receive for them. First, it argues, that, under the circumstances peculiar to mutual fund shares, the challenged regulation is in line with the general principles of valuation set out in Treasury Regulation 20.2031-1(b).[8] Second, the Government seeks to

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[8] Regulation 20.2031-1(b) in pertinent part reads:

(b) Valuation of property in general. The value of every item of property includible in a decedent's gross estate under sections 2031 through 2044 is its fair market value at the time of the decedent's death, except that if the executor elects the alternate valuation method under section 2032, it is the fair market value thereof at the date, and with the adjustments, prescribed in that section. The fair market value is the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts. The fair market value of a particular item of property includible in the decedent's gross estate is not to be determined by a forced sale price. Nor is the fair market value of an item of property to be determined by the sale price of the item in a market other than that in which such item is most commonly sold to the public, taking into account the location of the item wherever appropriate. Thus, in the case of an item of property includible in the decedent's gross estate, which is generally obtained by the public in the retail market, the fair market value of such an item of property is the price at which the item or a comparable item would be sold at retail. For example, the fair market value of an automobile (an article generally obtained by the public in the retail market) includible in the decedent's gross estate is the price for which an automobile of the same or

analogize its method of valuing shares in mutual funds to the method of valuing single premium insurance policies sustained by the Supreme Court in *Guggenheim* v. *Rasquin*, 312 U. S. 254 (1941). These two main lines of the Government's argument were adequately refuted in Judge Curtin's opinion below and we fully concur in his reasoning disposing of them. We will not restate the district court's conclusions found in 323 F. Supp. at 772-773, but instead address ourselves to some of the more peripheral issues the Government raises on appeal.

The Government forcefully contends that mutual fund shares have a value beyond the redemption price and that that value is reasonably measured by the added amount represented by the load charge. We quote from page 17 of its brief: "The estate and the decedent's beneficiaries may continue to own the mutual fund shares, which provide not only the right

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approximately the same description, make, model, age, condition, etc., could be purchased by a member of the general public and not the price for which the particular automobile of the decedent would be purchased by a dealer in used automobiles. Examples of items of property which are generally sold to the public at retail may be found in §§ 20.2031-6 and 20.2031-8. The value is generally to be determined by ascertaining as a basis the fair market value as of the applicable valuation date of each unit of property. For example, in the case of shares of stock or bonds, such unit of property is generally a share of stock or a bond. Livestock, farm machinery, harvested and growing crops must generally be itemized and the value of each item separately returned. Property shall not be returned at the value at which it is assessed for local tax purposes unless that value represents the fair market value as of the applicable valuation date. All relevant facts and elements of value as of the applicable valuation date shall be considered in every case.

to redeem, but also the right to retain the property for its investment features, which include the possibility of capital gains and dividends which may be used to purchase additional shares at less than the public offering price . . . , the diversification of investment for a small outlay, and expert management." This argument applies with equal force to the shares of numbers of corporations listed on the stock exchanges, not only to the mutual fund shares. Clearly, the commissions paid to brokers when shares in these companies are bought or sold are not in payment for, or a measure of, the value beyond the resale price, but are rather simply compensation to the broker for his services. The fallacy in the Government's position was demonstrated by Tax Court Judge Tannenwald when he spoke for the minority of the Tax Court in *Wells* v. *Commissioner*, 50 T. C. 871, 880 (1968).[4] That court by a vote of 7 to 6 held the regulation in issue here to be a reasonable one. Judge Tannenwald stated:

> The emphasis by the majority on the fact that the estate and the beneficiaries may continue to own the mutual fund shares and thereby enjoy the benefits of ownership is, in my opinion, wholly misplaced. These possibilities exist with respect to every type of security. If the majority standard is correct, it would be no less "appropriate" to use replacement cost with respect to marketable securities of all kinds. This, however, is simply not the law. That there may be an equivalence of replacement cost and fair market

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[4] The majority decision was affirmed in *Ruehlmann* v. *Commissioner of Internal Revenue*, 418 F.2d 1302 (6 Cir. 1969), *cert. denied*, 398 U.S. 950 (1970).

value in some situations does not justify the substitution of the former for the latter as the criterion in other situations where different considerations are involved.

The Government suggests that the challenged regulation only applies a general principle of valuation to the valuation of mutual fund shares that a unit of property is worth what a purchaser would have to pay to obtain similar property in the open market, that is, its retail price, and points to Treasury Regulation 20.2031-1(b)[8] as support for the suggestion. However, if there is indeed a widely accepted principle of valuation contained within that recently revised regulation, it is most certainly embodied in the sentence, "All relevant facts and elements of value as of the applicable valuation date shall be considered in every case." We would agree with the *Ruehlmann* case, *supra* at 1034, that the retail sales price of a property unit may be an important factor in the determination of its fair market value; yet it is also clear that other factors can affect the price which a willing seller reasonably could expect to receive from a sale of that particular unit, and if these other factors cause the retail price to be an unreasonable or unrealistic value standard, the retail price has not always been followed in valuation disputes as the sole criterion of value.[9]

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[8] See Footnote 3.

[9] *Duke* v. *Commissioner of Internal Revenue*, 200 F.2d 82 (1952), cited by the Government, in no way contradicts that principle, for, as was pointed out by Judge Frank in that opinion, in *Duke* there was no evidence of the fair market value of the property in question other than its retail value.

In his dissent in *Wells, supra* at 878, Judge Tannenwald cited two examples of this principle which we find very persuasive. He pointed out that "when the open-market price of bonds is less than par but the bonds can be applied at par in payment of the decedent's estate tax, the par value is includable in the gross estate. *Bankers Trust Co.* v. *United States*, 284 F. 2d 537 (C. A. 2, 1960), *certiorari denied* 366 U.S. 903 (1961); *Candler* v. *United States*, 303 F. 2d 439 (C. A. 5, 1962)." He also found support for the principle in a Treasury Regulation relating to an area which is strikingly similar to that in the present case, a regulation relative to the valuation of shares of corporate stock which are subject to a restrictive agreement that they cannot be sold unless first offered to the corporation itself, or to a third person, at a specified price. If such a restriction upon the transfer of stock is created in an arm's length transaction, Treasury Regulation 20.2031-2(h) (1958) requires that the price so specified be determined to be the fair market value of the shares.[7]

Thus according to generally accepted principles of valuation, the Government's theories of retail value should not be applied in this case. As we have stated, fair market valuation requires that consideration be accorded to all factors affecting the value of the

[7] The district court in the *Davis* case thought that the situations were so similar that similar treatment was required. To quote the court in that case in 306 F. Supp. at 955: "Although there is no binding contract in this case, the rationale of Treas. Reg. 20.2031-2(h) (1958) should apply to the open-end investment shares because the redemption price offered by the company truly represents the only realistic value that the estate can obtain for the shares of the open-end investment company."

property and not the retail sales price alone. Obviously, here, the estate can realistically expect to receive only the net asset value of the shares, not the price the general public would pay for them. We therefore agree with the court below that Treasury Regulation 20.2031-8(b) is an unreasonable regulation.

The lower court judgment for taxpayer is affirmed.

APPENDIX C

UNITED STATES COURT OF APPEALS
FOR THE
SECOND CIRCUIT

At a Stated Term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Courthouse in the City of New York, on the twenty-seventh day of March one thousand nine hundred and seventy-two.

Present:

HON. STERRY R. WATERMAN,
HON. J. JOSEPH SMITH,
HON. WILLIAM H. TIMBERS,
Circuit Judges.

DOUGLAS B. CARTWRIGHT, as Executor of the Estate of ETHEL B. BENNETT, PLAINTIFF-APPELLEE

v.

UNITED STATES OF AMERICA, DEFENDANT-APPELLANT

Appeal from the United States District Court for the Western District of New York.

This cause came on to be heard on the transcript of record from the United States District Court for the Western District of New York, and was argued by counsel.

ON CONSIDERATION WHEREFORE, it is now hereby ordered, adjudged, and decreed that the judgment of said District Court be and it hereby is affirmed with costs to be taxed against the appellant.

A. DANIEL FUSARO,
Clerk

APPENDIX D

Internal Revenue Code of 1954 (26 U. S. C.):

SEC. 1014. BASIS OF PROPERTY ACQUIRED FROM A DECEDENT.

(a) *In General.*—Except as otherwise provided in this section, the basis of property in the hands of a person acquiring the property from a decedent or to whom the property passed from a decedent shall, if not sold, exchanged, or otherwise disposed of before the decedent's death by such person, be the fair market value of the property at the date of the decedent's death, or, in the case of an election under either section 2032 or section 811(j) of the Internal Revenue Code of 1939 where the decedent died after October 21, 1942, its value at the applicable valuation date prescribed by those sections.

* * * *

SEC. 1015. BASIS OF PROPERTY ACQUIRED BY GIFTS AND TRANSFERS IN TRUST.

(a) *Gifts After December 31, 1920*—If the property was acquired by gift after December 31, 1920, the basis shall be the same as it would be in the hands of the donor or the last preceding owner by whom it was not acquired by gift, except that if such basis (adjusted for the period before the date of the gift as provided in section 1016) is greater than the fair market value of the property at the time of the gift, then for the purpose of determining loss the basis shall be such fair market value. If the facts necessary to determine the basis in the hands of the

donor or the last preceding owner are unknown to the donee, the Secretary or his delegate shall, if possible, obtain such facts from such donor or last preceding owner, or any other person cognizant thereof. If the Secretary or his delegate finds it impossible to obtain such facts, the basis in the hands of such donor or last preceding owner shall be the fair market value of such property as found by the Secretary or his delegate as of the date or approximate date at which, according to the best information that the Secretary or his delegate is able to obtain, such property was acquired by such donor or last preceding owner.

* * * * *

SEC. 2031. [as amended by Sec. 18(a), Revenue Act of 1962, P. L. 87-834, 76 Stat. 960]. DEFINITION OF GROSS ESTATE.

(a) *General.*—The value of the gross estate of the decedent shall be determined by including to the extent provided for in this part, the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated.

(b) *Valuation of Unlisted Stock and Securities.*—In the case of stock and securities of a corporation the value of which, by reason of their not being listed on an exchange and by reason of the absence of sales thereof, cannot be determined with reference to bid and asked prices or with reference to sales prices, the value thereof shall be determined by taking into consideration, in addition to all other factors, the value of stock or securities of corporations engaged in the same

or a similar line of business which are listed on the exchange.

SEC. 2033. [As amended by Sec. 18(a), Revenue Act of 1962, *supra*]. PROPERTY IN WHICH THE DECEDENT HAD AN INTEREST.

The value of the gross estate shall include the value of all property to the extent of the interest therein of the decedent at the time of his death.

Treasury Regulations on Estate Tax (1954 Code) (26 C. F. R.):

§ 20.2031-1 *Definition of gross estates; valuation of property.*

* * * * *

(b) *Valuation of property in general.* The value of every item of property includible in a decedent's gross estate under sections 2031 through 2044 is its fair market value at the time of the decedent's death, except that if the executor elects the alternate valuation method under section 2032, it is the fair market value thereof at the date, and with the adjustments, prescribed in that section. The fair market value is the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts. The fair market value of a particular item of property includible in the decedent's gross estate is not to be determined by a forced sale price. Nor is the fair market value of an item of property to be determined by the sale price of the item in a market other

than that in which such item is most commonly sold to the public, taking into account the location of the item wherever appropriate. Thus, in the case of an item of property includible in the decedent's gross estate, which is generally obtained by the public in the retail market, the fair market value of such an item of property is the price at which the item or a comparable item would be sold at retail. For example, the fair market value of an automobile (an article generally obtained by the public in the retail market) includible in the decedent's gross estate is the price for which an automobile of the same or approximately the same description, make model, age, condition, etc., could be purchased by a member of the general public and not the price for which the particular automobile of the decedent would be purchased by a dealer in used automobiles. Examples of items of property which are generally sold to the public at retail may be found in § § 20.2031-6 and 20.2031-8. The value is generally to be determined by ascertaining as a basis the fair market value as of the applicable valuation date of each unit of property. For example, in the case of shares of stock or bonds, such unit of property is generally a share of stock or a bond. Livestock, farm machinery, harvested and growing crops must generally be itemized and the value of each item separately returned. Property shall not be returned at the value at which it is assessed for local tax purposes unless that value represents the fair market value as of the applicable valuation date. All relevant facts and elements of value as of the applicable valuation date shall

be considered in every case. The value of items of property which were held by the decedent for sale in the course of a business generally should be reflected in the value of the business. For valuation of interests in businesses, see § 20.2031-3. See § 20.2031-2 and §§ 20.2031-4 through 20.-2031-8 for further information concerning the valuation of other particular kinds of property. For certain circumstances under which the sale of an item of property at a price below its fair market value may result in a deduction for the estate, see paragraph (d) (2) of § 20.2053-3.

* * * * *

§ 20.2031-8 *Valuation of certain life insurance and annuity contracts; valuation of shares in an open-end investment company.*

* * * * *

(b) *Valuation of shares in an open-end investment company.* (1) The fair market value of a share in an open-end investment company (commonly known as a "mutual fund") is the public offering price of a share, adjusted for any reduction in price available to the public in acquiring the number of shares being valued. In the absence of an affirmative showing of the public offering price in effect at the time of death, the last public offering price quoted by the company for the date of death shall be presumed to be the applicable public offering price. If the alternate valuation under section 2032 is elected, the last public offering price quoted by the company for the alternate valuation date shall be the applicable public offering

price. If there is no public offering price quoted by the company for the applicable valuation date (e.g.), the valuation date is a Saturday, Sunday, or holiday), the fair market value of the mutual fund share is the last public offering price quoted by the company for the first day preceding the applicable valuation date for which there is a quotation, adjusted for any reduction in price available to the public in acquiring the number of shares being valued. In any case where a dividend is declared on a share in an open-end investment company before the decedent's death but payable to shareholders of record on a date after his death and the share is selling "ex-dividend" on the date of the decedent's death, the amount of the dividend is added to the ex-dividend quotation in determining the fair market value of the share as of the date of the decedent's death. As used in this paragraph, the term "open-end investment company" includes only a company which on the applicable valuation date was engaged in offering its shares to the public in the capacity of an open-end investment company.

(2) The provisions of this paragraph shall apply with respect to estates of decedents dying after October 10, 1963.

Treasury Regulations on Gift Tax (1954 Code) (26 C. F. R.):

SEC. 25.2512-6. Valuation of certain life insurance and annuity contracts; valuation of shares in an open-end investment company.

* * * *

(b) *Valuation of shares in an open-end investment company.* (1) The fair market value of a share in an open-end investment company (commonly known as a "mutual fund") is the public offering price of a share, adjusted for any reduction in price available to the public in acquiring the number of shares included in the particular gift. In the absence of an affirmative showing of the public offering price in effect at the time of the gift, the last public offering price quoted by the company for the date of the gift shall be presumed to be the applicable public offering price. If there is no public offering price quoted by the company for the date of the gift (e.g., the date of the gift is a Saturday, Sunday or holiday), the fair market value of the mutual fund share is the last public offering price quoted by the company for the first day preceding the date of the gift for which there is a quotation, adjusted for any reduction in price available to the public in acquiring the number of shares included in the particular gift. As used in this paragraph, the term "open-end investment company" includes only a company which on the date of the gift was engaged in offering its shares to the public in the capacity of an open-end investment company.

(2) The provisions of this paragraph shall apply with respect to gifts made after October 10, 1963.

(26 C. F. R., Sec. 25.2512-6.)

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